

STATE OF NEW YORK

DEPARTMENT OF TAXATION AND FINANCE

CORPORATION TAX BUREAU - CORPORATION TAX BUREAU

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In the Matter of the Application of

KAYOS PRODUCTIONS, INC.

for revision or refund of franchise  
tax under Article 9-A of the Tax Law  
for the fiscal year ended August 31,  
1964.

Hearing Case No. 6464

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The taxpayer filed a completed return on November 16, 1964 for the fiscal year ended August 31, 1964, showing computation of tax, which was paid in full, as follows:

Entire Net Income	\$251,818.13
Business allocation %	38.03%
Allocated income	95,766.43
Tax at 5½%	5,267.15

The business allocation was made up of:

Property	100.00%
Receipts	10.10%
Wages	<u>3.98%</u>
Total Factors	114.08%
Business allocation (divided by 3)	38.03%

On November 10, 1967 taxpayer filed a timely application for revision or refund accompanied by an amended return which eliminated the property factor and used the remaining two factors, receipts and wages, resulting in a business allocation of 7.04%. Taxpayer contends that inclusion of the property factor produces a distortion of income earned in New York.

An informal hearing was held in New York City on June 12, 1968 before J. J. Genevich. The taxpayer was represented by P. H. Wolfowitz, CPA, and his assistant, H. Saraga, of the accounting firm of Charles H. Renthal & Co., 641 Lexington Ave., New York, N.Y. 10022.

The information on file discloses:

Receipts Factor

During the fiscal year ended August 31, 1964 the corporation was engaged in rendering services in California as a producer of motion picture films for which it received service fees aggregating \$600,000 allocable to California. The taxpayer treated as New York receipts \$42,000 received from C.B.S. for the repeat exhibition of two television films and \$25,395.71 received from Twentieth Century Fox for the exhibition of a motion picture film. All films involved had been made in years prior to the fiscal year ended August 31, 1964, but the taxpayer allocated the respective receipts to New York because the films had originally been produced in this state.

Wage Factor

The taxpayer allocated \$9,562.63 to New York, representing additional salary payments made for a T.V. film which had originally been produced in this state. These additional salary payments were required to be made, pursuant to contract, when the film was repeated on television.

The denominator of \$240,486.93 included \$230,924.30 allocable to California, consisting of \$11,107.72 paid to an executive officer and the balance paid to employees engaged in producing films.

Property Factor

The property factor consisted of \$634.60 average value of furniture and fixtures located in the New York home of one of the officers, plus \$1,000 residual value of a short film made in 1959 at a cost of \$18,000. The taxpayer allocated the residual value of \$1,000 entirely to New York, although it was in the hands of a distributor, Brandon Films, which had places of business throughout the country.

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The taxpayer filed its California franchise return using the three-factor formula. The business allocation was 61.97%, consisting of (1) zero property, (2) receipts of 89.90% and (3) wages of 96.02%.

The California taxing authorities audited the return and refused to allow a three-factor formula. They contended that since the taxpayer was basically engaged in a service business, inclusion of a property factor produced a distorted result; especially in this case, the property being insignificant and bearing no relationship to the production of income reported on the return. Accordingly, California reassessed the tax using a two-factor formula of receipts and wages, resulting in a business allocation of 92.96%.

As a result of the California audit, taxpayer thereupon filed its application for revision or refund with us, requesting similar use of a two-factor formula for New York purposes.

In a situation where a taxpayer has only furniture and fixtures, it is the usual policy of the department to use Ruling 1 and substitute an expense factor for the property factor. However, Ruling 1 is not applicable in this case since the taxpayer has other tangible personal property in addition to furniture and fixtures, namely, a motion picture negative and prints.

In order to produce an equitable result, it is recommended that we follow method No. 1 listed in Section 4.28 b of Ruling of the State Tax Commission dated March 15, 1962. This provides for "excluding one or more of the factors" therein. It is believed that we should exclude the property factor, as California has done, since the items involved are insignificant and had no impact at all on the earning of the income reported on the return. The taxpayer testified that on a separate accounting basis the income attributable to New York is \$16,850. The two factors of receipts and wages produce a slightly larger base.

A small adjustment is necessitated in the computation of the wage factor, by eliminating from the denominator wages of \$11,107.72

paid to an executive officer. The two-factor formula, consisting of receipts as reported, 10.10%, and revised wages of 4.16%, produces a business allocation of 7.13%, resulting in a reduction of tax as follows:

Entire net income	\$251,818.13
Business allocation %	7.13%
Allocated ancome	17,954.63
Tax at 5½%	987.50
Tax paid	5,267.15
Reduction in Tax	\$ 4,279.65

/s/

W. F. SULLIVAN  
Chairman

/s/

J. J. CENEVICH

JJG:MB  
7/10/68

Approved  
E. A. DORAN

Approved  
8/19;68 A. B. MANLEY